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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1931

No. 270

THE PACIFIC CO., LTD., APPELLANT,

vs.

CHARLES G. JOHNSON, STATE TREASURER OF THE STATE OF CALIFORNIA

APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

FILED JULY 31, 1931

(36,084)

(36,084)

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., SEPTEMBER 3, 1931

[fols. 1 & 2]

IN SUPREME COURT OF CALIFORNIA

Sac. No. 4500

THE PACIFIC CO., LTD., a Corporation, Appellant,

vs.

CHARLES G. JOHNSON, State Treasurer of the State of California, Respondent

Petition for Appeal, Assignment of Errors, and Prayer for Reversal—Filed June 18, 1931

PETITION FOR APPEAL

Considering itself aggrieved by the final decision of the Supreme Court of the State of California in the above entitled cause, the plaintiff therein, The Pacific Co., Ltd., hereby prays that an appeal be allowed to the Supreme Court of the United States, herein, and for an order fixing the amount of the bond thereon.

ASSIGNMENT OF ERRORS

And the said The Pacific Co., Ltd., assigns the following errors in the record and proceedings in the said case:

1. The Supreme Court of the State of California erred in deciding that the provisions of the Bank and Corporation Franchise Tax Act (California Statutes 1929, Chapter 13, Page 19), in so far as it declares and attempts to make taxable, income derived from bonds of improvement districts of the State of California held by the petitioner, which bonds were issued prior to November 6, 1928, under the provisions of Article 1 3/4, Section 13 of the Constitution of the State of California, providing that said bonds "shall be free and exempt from taxation", are not in viola-
[fol. 3] tion of Section 10 of Article I of the Constitution of the United States as impairing the obligation of contracts.

2. The Supreme Court of the State of California erred in deciding that the provisions of the Bank and Corpora-

tion Franchise Tax Act (California Statutes 1929, Chapter 13, Page 19), in so far as it declares and attempts to make taxable, income derived from bonds of improvements districts of the State of California, held by the petitioner, which bonds were issued prior to November 6, 1928, under the provisions of Article 1 3/4, Section 13, of the Constitution of the State of California, providing that said bonds "shall be free and exempt from taxation", are not in violation of Article XIV, Section 1 of the Articles in addition to and amendment of the Constitution of the United States as depriving the petitioner of its property without due process of law, and denying to it the equal protection of the law.

3. The Supreme Court of the State of California erred in deciding that the Legislature of the State of California by the enactment of the Bank and Corporation Franchise Tax Act (California Statutes 1929, Chapter 13, Page 19), was not attempting by indirection to levy a tax upon bonds of the improvement districts of the State of California, held by the petitioner, which bonds were issued prior to November 6, 1928, under the provisions of Article 1 3/4, Section 13 of the Constitution of the State of California, providing that said bonds "shall be free and exempt from taxation."

PRAYER FOR REVERSAL

For which errors the plaintiff, The Pacific Co., Ltd., prays that the said judgment of the Supreme Court of the State of California, dated May 1, 1931, in the above entitled cause, be reversed and a judgment rendered in favor of the said plaintiff, and for costs.

Dated June 16, 1931.

Joseph D. Peeler, Joseph D. Peeler, Melvin D. Wilson, Melvin D. Wilson, Counsel for Appellant.

[fol. 3½] [File endorsement omitted.]

[fol. 4] IN SUPREME COURT OF CALIFORNIA

[Title omitted]

ORDER ALLOWING APPEAL—Filed June 18, 1931

The appellant in the above entitled suit, having prayed for the allowance of an appeal in this cause to the Su-

preme Court of the United States from the judgment made and entered in the above entitled suit by the Supreme Court of the State of California on the first day of May, 1931, and from each and every part thereof, and having presented and filed their petition for appeal, assignment of errors, and prayer for reversal, pursuant to the statutes and the rules of the Supreme Court of the United States in such case made and provided:

It is now here ordered that an appeal be, and the same is hereby, allowed to the Supreme Court of the United States from the Supreme Court of the State of California in the above entitled cause, as provided by law, and it is further ordered that the Clerk of the Supreme Court of the State of California shall prepare and certify a transcript of the record, proceedings and judgment in this cause and transmit the same to the Supreme Court of the United States, so that he shall have the same in said Court within sixty days of this date.

And it is further ordered that security for costs on appeal be fixed in the sum of $500.00.

Dated June 18th, 1931.

Emmet Seawell, Acting Chief Justice of the Supreme Court of the State of California.

[File endorsement omitted.]

[fol. 5] IN SUPREME COURT OF CALIFORNIA

[Title omitted]

CLERK'S CERTIFICATE

I hereby certify that Associate Justice Emmet Seawell, the senior justice of this Court is, in accordance with the rules of this Court, made and adopted by this Court on September 2, 1926, the acting Chief Justice of said Court, and since Monday, June 15, 1931, has been such acting Chief Justice in the place and stead of the Honorable William H. Waste, who is now and since the day last above named has been absent from the state of California, and that said Acting Chief Justice Emmet Seawell is fully

authorized to act in the place and stead of said Chief Justice William H. Waste in all matters arising in said Court as fully as said Chief Justice may have acted if personally present.

B. Grant Taylor Clerk of Supreme Court, by I. Erb, Chief Deputy. (Seal.)

Dated June 23, 1931.

[fols. 6 & 7] Bond on appeal for $500.00, approved and filed June 26, 1931, omitted in printing.

[fols. 8 & 9] Citation, in usual form, showing service on U. S. Webb, filed June 18, 1931, omitted in printing.

[fol. 10] IN SUPREME COURT OF CALIFORNIA

[Title omitted]

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed June 26, 1931

To the Clerk of the Supreme Court of the State of California:

You are hereby requested to make a transcript of the record of this cause to be used in an appeal to the Supreme Court of the United States, the transcript to consist of the record on appeal in said cause, including the pleadings; the decision and the remittitur, besides copies of the petition for appeal, the assignment of errors, prayer for reversal, order of court allowing appeal, bond and citation, and copies of opinions of the Court, the counsel for the appellant deeming the above portions of the record to be material to and necessary for a decision of the questions involved.

Respectfully, Miller, Chevalier, Peeler & Wilson, by Joseph D. Peeler, by Melvin D. Wilson.

Dated: June 24, 1931.

[fol. 11] UNITED STATES OF AMERICA,
State of California,
County of ——:

Due and sufficient service of the within Præcipe is hereby accepted this — day of June, 1931.

Charles G. Johnson, State Treasurer of the State of California, (Signed) by H. H. Linney, Deputy Attorney General.

[fol. 11½] [File endorsement omitted.]

———

[fol. 12] [File endorsement omitted]

IN SUPERIOR COURT OF SACRAMENTO COUNTY

No. 45001

THE PACIFIC CO., LTD., a Corporation, Plaintiff,

vs.

CHARLES G. JOHNSON, State Treasurer of the State of California, Defendant

Recovery of Corporation Franchise Taxes Illegally Collected

AMENDED COMPLAINT—Filed Aug. 18, 1930

Comes now the plaintiff and for its amended cause of action alleges:

First Cause of Action

I

Plaintiff is and during all the time hereinafter mentioned was a California corporation, having its principal office in the Pacific Finance Building, 621 South Hope street, Los Angeles, California. Plaintiff was at the time of filing its franchise tax return, as hereinafter mentioned, called The Elliott Horne Co., but has changed its name to The Pacific Co., Ltd., under the procedure required by law for the change of corporate names.

II

Defendant is, and during all of the times hereinafter mentioned has been, state treasurer of California, and has his office and residence in Sacramento, Sacramento county, California. This action is brought against defendant as an officer acting under and by virtue of the Bank and Corporation Franchise Tax Act of California.

III

Plaintiff having applied for and received an extension to August 15, 1929, for filing its franchise tax return for the taxable period ended December 31, 1928, filed a franchise [fol. 13] tax return on August 10, 1929, under Article XIII, section 16 of the Constitution of California, and Statutes 1929, chap. 13, and paid to the defendant, for the privilege of doing business in corporate form throughout the calendar year 1929, taxes, interest and penalties as follows:

Date	Tax	Interest	Penalty	Totals
August 10, 1929 ...	$2,509.24	$37.64	.....	.....
Nov. 18, 1929	2,509.24	52.70	$125.46	.....
	$5,018.48	$90.34	$125.46	$5,234.28

IV

Included in the income upon which that tax was based was, as required by section 6 of the Bank and Corporation Franchise Tax Act, the amount of $651,732.75 profits received by plaintiff upon the purchase and sale of bonds issued prior to November 6, 1928, by various improvement districts, organized and existing under the laws of the state of California.

V

Article I, section 10 of the Constitution of the United States prohibits any state from passing a law which would impair the obligation of contracts. Articles XII, section 1 3/4 of the Constitution of California, provides that bonds issued by municipal corporations and improvement districts shall be exempt from taxation. Article I, section 16 of the Constitution of California, provides that no law impairing the obligation of contracts shall ever be passed.

VI

While all of the constitutional provisions mentioned above were in effect, and prior to November 6, 1928, the bonds in question were issued by various improvement districts in California. The issuance of these bonds, while the above-mentioned constitutional provisions were in ef-
[fol. 14] fect, constituted a contract between the state of California and the various improvement districts with the buyers of the bonds, that the bonds would be exempt from taxation.

VII

Plaintiff purchased certain of the said bonds of and from the California improvement districts, and, during the taxable year ended December 31, 1928, resold the same at profits totalling $651,732.75.

VIII

Plaintiff purchased the said bonds in sole reliance on the constitutional contract that the bonds and the income therefrom would, in accordance with the constitutional provisions, be entirely exempt from taxation.

IX

The Bank and Franchise Tax Act, section 6, required plaintiff to report as income, upon which the tax was based, the profits on the bonds, and plaintiff paid the tax measured by the said profits.

X

The imposition of the tax measured by the profit on the purchase and sale of such bonds constituted a tax on the bonds themselves.

XI

The taxation of the bonds by the state of California, after they had been issued under a contract that they would be exempt from taxation in California, impairs the obligation of that contract, and is void under article I, section 10 of the Constitution of the United States and under art. 1, sec. 16 of the Constitution of California.

XII

The elimination from gross income of the $651,732.75 profits on the purchase and sale of the improvement bonds [fol. 15] would eliminate the entire amount of taxable net income reported on the return, namely, $140,345.02.

XIII

The elimination of the taxable income entitled plaintiff to a refund of the tax, penalties and interest paid, except for the minimum tax of $25.00 as provided by section 4 of the Bank and Franchise Tax Act.

XIV

On June 9, 1930, plaintiff, in accordance with the law, filed with the Franchise Tax Commissioner of the state of California, its claim for refund of all tax, interest and penalties mentioned above, with the exception of the $25.00 minimum tax, namely, $4,993.48 tax, $125.46 penalty, and interest on said amounts.

XV

The basis of the claim for refund was the same as is stated in this amended complaint, namely, that the imposition of the tax on the profit from the purchase and sale of the bonds issued by the various improvement districts of California, amounted to the impairment of the obligation of the contract existing under the constitutional provisions mentioned herein, and was void.

XVI

The Franchise Tax Commissioner duly rejected the claim for refund on June 17 and/or July 7, 1930.

XVII

The claim for refund is the property of plaintiff and has not been assigned or transferred to any person, firm, or corporation.

[fol. 16] Second Cause of Action

I

Plaintiff refers to paragraphs I, II, III, V, VI, XI and XVII of the first cause of action and by reference incor-

porates them herein as if they were fully set forth in this second cause of action.

II

On March 17, 1930, the Franchise Tax Commissioner of the state of California mailed his notice of proposed assessment of additional franchise tax for the year ended December 31, 1928, of $6,692.96, plus interest at 6 per centum from the time *the time* the alleged tax was due. The basis of the proposed assessment was the inclusion in the tax base by the commissioner of $167,324.11 interest received by plaintiff in the calendar year 1928 from bonds issued (prior to November 6, 1928) by various improvement districts organized and existing under the laws of the state of California. The said interest was required by section 6 of the Bank and Corporation Franchise Tax Act to be included in income for the purpose of computing the tax.

III

On March 21, 1930, the plaintiff in the form required by the statute, protested the proposed assessment on the ground that the bonds and the interest on the bonds were exempt from taxation in California under the constitutional provisions mentioned above.

IV

On May 29, 1930, the commissioner notified plaintiff of his final action in the matter, which affirmed his proposed assesment. The commissioner's final notice demanded an additional tax of $6,692.96, plus interest.

V.

On June 6, 1930, plaintiff, under protest, paid the said tax and interest to the defendant. The grounds of protest [fol. 16½] were the same as set forth in the prior protest and the same as are set forth in this second cause of action.

VI

Plaintiff purchased the said bonds (issued prior to November 6, 1928) of and from the various improvement dis-

tricts, solely in reliance on the contract that the bonds and the income therefrom would, in consonance of the said constitutional provisions, be entirely exempt from taxation.

VII

The tax measured by the interest received from the said bonds amounts to a tax on the bonds themselves, and is in violation of article I, section 10 of the Constitution of the United States and article I, section 16 of the Constitution of California, void.

Third Cause of Action

I

Plaintiff refers to paragraphs I, II, III, V and XVII of the first cause of action, and to paragraphs III, V and VII of plaintiff's second cause of action, and by reference incorporates them herein as if they were fully set forth in this third cause of action.

II

While all of the constitutional provisions mentioned above were in effect, and after November 6, 1928, the bonds in question were issued by various improvement districts in California. The issuance of these bonds while the above-mentioned constitutional provisions were in effect, constituted a contract between the state of California, the various improvement districts, and the buyers of the bonds, that the bonds would be exempt from taxation.

III

On March 17, 1930, the franchise tax commissioner of [fol. 17] the state of California mailed his notice of proposed assessment of additional franchise tax for the year ended December 31, 1928, of $104.95, plus interest at 6 per centum from the time the alleged tax was due. The basis of the proposed assessment was the inclusion in the tax base by the commissioner of $2,624.07 interest received by plaintiff in the calendar year 1928 from bonds issued after November 6, 1928, by various improvement districts organized and existing under the laws of the state of California. The said interest was required by section 6 of the Bank and

Corporation Franchise Tax Act to be included in income for the purpose of computing the tax.

IV

On May 29, 1930, the commissioner notified plaintiff of his final action in the matter, which affirmed his proposed assessment. The commissioner's final notice demanded an additional tax of $104.95, plus interest for the taxable year ended December 31, 1928.

V

Plaintiff purchased the said bonds issued after November 6, 1928, of and from the various improvement districts, solely in reliance on the contract that the bonds and the income therefrom would, in consonance of the said constitutional provisions, be entirely exempt from taxation.

Wherefore plaintiff prays for judgment against the defendant as follows:

First Cause of Action

Original tax, $2,484.24, plus interest at 6% from March 15, 1929.

Original tax, $2,509.24, plus interest at 6% from Septem-
[fol. 18] ber 15, 1929.

Penalty, $125.46, plus interest at 6% from September 15, 1929.

Second Cause of Action

Additional tax, $3,346.48, plus interest at 6%, from March 15, 1929.

Additional tax, $3,346.48, plus interest at 6%, from September 15, 1929.

Third Cause of Action

Additional tax, $52.48, plus interest at 6%, from March 15, 1929.

Additional tax, $52.47, plus interest at 6%, from September 15, 1929, together with costs of suit.

Miller, Chevalier, Peeler & Wilson by Melvin D. Wilson, Attorneys for Plaintiff.

Duly sworn to by F. S. Baer. Jurat omitted in printing.

[File endorsement omitted.]

[fol. 19] IN SUPERIOR COURT OF SACRAMENTO COUNTY

DEMURRER TO AMENDED COMPLAINT—Filed Aug. 28, 1930

Comes now Charles G. Johnson, as treasurer of the state of California, defendant herein, and answering plaintiff's amended complaint, demurs thereto and for grounds of demurrer says:

I

That said amended complaint does not state facts sufficient to constitute a cause of action against said defendant.

Wherefore defendant prays that said action be dismissed and for his costs herein expended.

U. S. Webb, Attorney General of the State of California; H. H. Linney, Deputy Attorney General; Albert F. Zangerle, Deputy Attorney General, Attorneys for Defendant.

[File endorsement omitted.]

[fol. 20] IN SUPERIOR COURT OF SACRAMENTO COUNTY

THE PACIFIC COMPANY, LTD., Plaintiff,

vs.

CHARLES G. JOHNSON, etc., Defendant

ORDER SUSTAINING DEMURRER—Sept. 8, 1930

The demurrer to the complaint in the above entitled cause came on regularly this day for hearing. Miller, Chevalier and Peeler, counsel for plaintiff, and U. S. Webb, attorney general of the state of California, —— ——, deputy attorney general, appearing in court.

Thereupon said demurrer was partially argued to court by counsel for respective parties, and the court upon its own motion, and counsel for respective parties consenting thereto orders that the demurrer in the above entitled cause be and the same is hereby sustained without leave to amend.

IN SUPERIOR COURT OF SACRAMENTO COUNTY

NOTICE OF APPEAL FROM JUDGMENT—Filed Sept. 8, 1930

Notice is hereby given that plaintiff in the above-entitled action does hereby appeal to the Supreme Court of the state of California from that certain judgment heretofore and on or about the 8th day of September, 1930, made and entered therein, in said Superior Court, in favor of the defendant in said action and against said plaintiff, and from the whole thereof.

Dated September 8th, 1930.

Miller, Chevalier, Peeler & Wilson, by Melvin D. Wilson, Attorneys for Plaintiff.

[File endorsement omitted.]

[fol. 21] IN SUPERIOR COURT OF SACRAMENTO COUNTY

NOTICE TO COUNTY CLERK FOR PREPARATION OF TRANSCRIPT ON APPEAL AND FROM JUDGMENT—Filed Sept. 8, 1930

To the County Clerk of the County of Sacramento, State of California, and ex-officio Clerk of the above-entitled Superior Court:

You will please take notice that plaintiff in the above-entitled action desires and intends to appeal to the Supreme Court of the state of California from the judgment heretofore and on or about the 8th day of September, 1930, made and entered in the above-entitled court and action in favor of the above-named defendant, and against the said plaintiff, and from the whole of said judgment, and that pursuant to the provisions of section 953-A of the Code of Civil Procedure said plaintiff does hereby request that a transcript be made up and prepared of the papers used in said action, wherein and as a result of which said trial said judgment was made and entered, and of any and all other proceedings of any kind at said trial and of any and all notices, papers, pleadings, records, proceedings or orders filed, had or made with reference thereto. Such transcript to be made up and prepared as the transcript on appeal

from said judgment in accordance with the provisions of section 953-A of the Code of Civil Procedure.

You are further hereby requested to prepare a clerk's transcript for use on said appeal from said judgment which shall contain each and all of the papers, matters and things required by sections 950 and 951 of the Code of Civil Procedure to be furnished on appeal from a final judgment.

You are advised that said plaintiff has arranged with the stenographic reporter for his compensation.

Dated September 8th, 1930.

Miller, Chevalier, Peeler & Wilson, by Melvin D. Wilson, Attorneys for Plaintiff.

[File endorsement omitted.]

[fol. 22] Clerk's certificate to foregoing transcript omitted in printing.

[fols. 23 & 23½] In Superior Court of Sacramento County

Suit No. 45001. Decree No. 25476

Decree Entered Oct. 14, 1930, at 2:15 o'clock p. m., Nunc pro tunc. Sep. 8, 1930

Judgment—Filed Oct. 14, 1930

Judgment for Defendant

This cause coming regularly on for hearing this 8th day of September, 1930, by the court, upon defendant's demurrer to plaintiff's amended complaint, and the court having heard the arguments thereon and the matter being submitted for decision.

It is ordered, adjudged and decreed that defendant's demurrer to plaintiff's amended complaint be and the same is hereby sustained without leave to amend, and judgment is hereby rendered nun pro tunc in accordance with the stipulation of both parties on file herein in favor of the

defendant and that plaintiff take nothing by its said action and that defendant recover his costs.

Done in open court this 14th day of October, 1930.

John F. Pullen, Judge of the Superior Court.

Attest: Harry W. Hall, Clerk, by Wm. H. Dick, Deputy Clerk. (Seal.)

[File endorsement omitted.]

[fol. 24] IN SUPREME COURT OF CALIFORNIA

In Bank

Sac. No. 4500

THE PACIFIC CO., LTD. (a Corporation), Plaintiff and Appellant,

v.

CHARLES G. JOHNSON, State Treasurer of the State of California, Defendant and Respondent

[1] Taxation—Corporations—Franchises—Conditions.—In granting a franchise to a corporation, the state may limit the powers to be exercised under it, annex conditions to its enjoyment, and require the corporation to contribute to the revenues of the state.

[2] Id.—Franchises—Property.—A franchise tax is a tax imposed upon a corporation for the right or privilege of being a corporation or of doing business in a corporate capacity, and differs materially from property taxes as levied for state and municipal purposes in the basis prescribed for computing the amount of the tax, and where a tax is lawfully imposed upon the exercise of privileges within the taxing power of the state or nation, the measure of such tax may be the income from the property of the corporation, although a part of such income is derived from property in itself nontaxable.

[3] Id.—Corporations—Banks and Banking—Franchises—Constitutional Law.—The Bank and Corporation

Franchise Tax Act (Stats. 1929, p. 19), which provides for and requires the inclusion of interest from "federal, state, municipal or other bonds" in the net income base by which the state franchise tax of banks and corporations is measured, provides only for a franchise tax and not a tax on the property held by banks or corporations, and it is not, therefore, in violation of section 1¾ of article XIII of the state Constitution exempting from taxation all bonds issued by the state, or any county, city and county, municipal corporation or district thereof, nor in violation of the provisions of the state and federal constitutions forbidding the state to pass any law impairing the obligation of contract, and the fact that a portion of the net income upon which the franchise tax is based may be from property which is itself nontaxable is immaterial.

[4] Id. — Bonds — Sale of — Profits—Exemptions.—Although federal, state and municipal bonds may be exempt from direct taxation, profits derived from the purchase and sale of such securities are to be included in the net income of a corporation or bank which is used as a basis for determining the amount of the state franchise tax under the Bank and Corporation Franchise Tax Act (Stats. 1929, p. 19).

Appeal by plaintiff from a judgment of the Superior Court of Sacramento County, John F. Pullen, Judge, in an action to recover taxes paid under protest. Affirmed. Langdon, J., dissents.

For Appellant: Miller, Chevalier, Peeler & Wilson; Melvin D. Wilson.

For Respondent: U. S. Webb, Attorney-General; H. H. Linney, Deputy Attorney-General; Frank L. Guerena, of Counsel.

OPINION—March 31, 1931

Plaintiff seeks to recover certain taxes paid under protest and alleged to have been unconstitutionally exacted. Defendant's general demurrer to the complaint was sustained without leave to amend. From the judgment thereafter entered plaintiff prosecuted this appeal, urging the invalidity of those portions of the Bank and Corporation

Franchise Tax Act (Stats. 1929, chap. 13, p. 19), which provide for and require the inclusion of interest from "federal, state, municipal or other bonds" in the net income base by which the state franchise tax of banks and corporations is measured. The importance, both to the taxing power and the taxpayer, of a proper determination of this issue prompts us to briefly review the history of state taxation, in order that a complete understanding may be had of the origin of the statute here assailed, the principles underlying it, and the legal and economic factors that made imperative its enactment. The materiality of such investigation will subsequently appear.

Prior to 1910, state revenues were derived mainly from a direct ad valorem property tax levied upon all taxable [fol. 25] property within the state. Under this system, corporate property was subject to both state and county levies, and in time the method was found to be unsatisfactory, burdensome, and, in some cases, inequitable. (Pacific G. & E. Co. v. Roberts, 168 Cal. 420, 423, 143 Pac. 700.) This led to the creation of a commission whose task it was to study the situation and suggest a remedy. The plan proposed by this commission was adopted in 1910 (sec. 14 of art. XIII, Const.), and certain corporations were thereupon placed in a class apart and their franchises taxed exclusively for state purposes. Under this constitutional amendment and the several legislative acts passed pursuant thereto, the state tax on public utilities was determined by a percentage of their gross earnings; that on insurance companies by a percentage of their gross premiums; that on banks (national and state) by a percentage of their capital, surplus and undivided profits; and that on other corporations by a percentage of the "actual cash value" of their franchises. This system of taxation was not seriously challenged until the year 1927, when a crisis in bank taxation became acute. The reason for this difficulty is traceable to the fact that national banks, as instrumentalities of the federal government, are taxable by the states only with the authority of congress, and within the limits prescribed by that body. Until 1864 no provision was made for state taxation of national banks. In 1868 congress enacted, and has amended from time to time,

section 5219 of the Revised Statutes, setting out the methods by which national banks may be taxed, and the limitations within which the local taxing bodies may act. When California adopted its 1910 method of taxing banks, utilities and other corporations, section 5219 permitted, as reflected in our law as it then read, only one form of levy on national banks, viz., a tax on shares. The right to levy such tax was subject to two conditions, namely, (1) the rate could not be higher than that assessed in the state levying the tax upon other moneyed capital in the hands of individual citizens; and (2) the tax was to be in lieu of all other state, county or municipal charges except taxes on real property. This single authorized method of levy on national banks led to the growth of a more or less uniform system of taxation on these institutions throughout the country; that is to say, the combined value of capital, surplus and undivided profits was made the base of the tax, and the local rate was applied.

In time, however, difficulty with this method of taxing national banks arose because of the limitation that the rate of tax on national bank shares should not be in excess of that assessed upon other moneyed capital in competition with banks. The judicial history of section 5219, supra, has been written around attempts of the courts to explain the key words, "other moneyed capital in the hands of individual citizens". In 1921, the Supreme Court of the United States declared the Virginia tax on national banks invalid because it violated this provision. (Merchants Nat. Bank v. City of Richmond, 256 U. S. 635.) This decision was promptly used by national banks throughout the country to test the validity of the various laws under which they were being taxed. The existence of these and other conditions led to the amendment of section 5219, supra, in 1923, and again in 1926. Under this latest amendment, and as the section now reads, the states are authorized, subject to certain conditions, to (1) tax the shares of national banks to their owners; or (2) include the dividends therefrom in the taxable income of the owners or holders thereof; or (3) tax the banks on their net income; or (4) tax the banks according to or [fol. 26] measured by their net income. The section further provides that in the case of a tax according to or

measured by net income, the taxing state may "include the entire net income received from all sources", but the rate shall not be higher than the rate assessed upon state banks or other corporations. The states of New York, Massachusetts, Wisconsin, Oregon, and Washington were quick to take advantage of the authority given by this amendment of section 5219, supra, and state statutes imposing "franchise" taxes on national banks and other financial and business corporations, and measured by or according to their net income were enacted.

Examination of the final (1929) report of the California tax commission (California State Printing Office Publication No. 63725) discloses that that commission, after an extended and careful study of the state taxing situation, concluded that there was immediate and dire need for a change in the method by which banks and corporations were being taxed in this state. As intimated in the report, this conclusion was prompted in part by certain decisions of the United States Supreme Court (First National Bank v. City of Hartford, 273 U. S. 548; State of Minnesota v. First National Bank, 273 U. S. 561) interpreting the phrase, "other moneyed capital in the hands of individual citizens", appearing in section 5219, supra, and by the decision of this court in validating the Solvent Credits Acts of 1925 and 1927. (Arnold v. Hopkins, 203 Cal. 553, 265 Pac. 223.) The report of the commission states, in part: "Under the interpretation of the existing federal statute [sec. 5219] the method of taxing banks now in force in this state can apparently be maintained only at the sacrifice of the special treatment of intangibles, which is greatly desired by the public, and at the cost of the taxation of mortgages. There is no assurance that the Congress will extend further the state's power to tax banks and the commission believes that mortgages should not be taxed. Consequently some new method of taxing banks must be sought." It was estimated that if the crisis caused by the federal decisions and the existing condition of the state taxing system were not met by an immediate constitutional amendment and legislative enactment, the state would be faced with the likely loss of all revenue from banks beginning with the fiscal year July 1, 1926—a loss, if suffered, of approximately $22,000,000. The tax commission thereupon concluded "that the only practicable method of securing a sub-

stantial revenue from the banks is to proceed under the fourth method permitted by the federal statute, and tax banks 'according to or measured by net income'". Under this method, it was stated, "the state may continue to exempt real estate mortgages and may enact a solvent-credits law without danger of invalidating the bank tax." It was therefore recommended to the governor that a special session of the legislature be called to consider the submission to the people of an amendment to the state Constitution providing for a tax on banks "according to or measured by their net income." Pursuant to this suggestion, and in response to a call from the governor, the legislature met in special session on September 4, 1928, and on the following day voted to submit to the people an amendment authorizing this new method for taxing banks and other corporations and providing for the taxation of intangibles. The proposed amendment (sec. 16, art. XIII, Const.) was adopted by popular vote at the general election on November 6, 1928. It provides that "Notwithstanding any other provision of the Constitution", banks, including national banking associations, and all financial, [fol. 27] mercantile, manufacturing and business corporations shall annually pay to the state a tax to be measured by or according to their net income, and that the legislature may define net income "to be the entire net income received from all sources."

In conformity with the provisions of this constitutional amendment the legislature at its regular session in 1929, enacted the California Bank and Corporation Franchise Tax Act, supra, the validity of which is now brought into question. This statute is the first departure from the general theory that property should be the fundamental test of the adequacy of all business taxation in California. In so far as material here, the act provides, in substance:

Section 1. Every national bank located within this state shall annually pay to the state a tax according to or measured by its net income to be computed at the rate of four per cent upon the basis of its net income for the next preceding fiscal or calendar year;

Section 2. Every bank, other than a national bank, doing business within this state, shall annually pay to the state "for the privilege of exercising its corporate franchises

within this state", a tax according to or measured by its net income, to be computed at the rate of four per cent upon the income for the next preceding fiscal or calendar year;

Section 4. Every financial, mercantile, manufacturing and business corporation, doing business within this state, shall annually pay to the state, "for the privilege of exercising its corporate franchises within this state", a tax according to or measured by its net income, to be computed at the rate of four per cent upon its net income for the next preceding fiscal or calendar year;

Section 6. The term "gross income" includes, among other things, "all interest received from federal, state, municipal or other bonds".

Section 7. The term "net income" means the gross income less the deductions allowed, no deduction being allowed for interest received from federal, state, municipal or other tax exempt bonds.

As intimated at the commencement of this opinion, it is the appellant's contention that the act is unconstitutional and void in so far as it attempts to include interest from tax-exempt bonds in the tax base. In support thereof, reliance is placed by appellant on section 1¾ of article XIII of the state Constitution exempting from taxation all bonds issued by the state, or any county, city and county, municipal corporation or district thereof, and on section 10 of article I of the federal Constitution and sect[illegible] of article I of the state Constitution forbidding the [illegible]te to pass any law impairing the obligation of contracts. In short, appellant urges that to permit the state to include interest from tax-exempt bonds in the tax base is to permit it to do indirectly what it cannot do directly. The attorney-general replies that it has been consistently held by the United States Supreme Court that either the federal government or a state government "may legally impose a franchise tax upon corporations for the right to exercise their corporate privileges, measured in amount by a percentage of net income although a portion of the income is derived from property which in itself is nontaxable, the court stating that the distinction lies between the attempt to tax the property as such and to measure a legitimate tax upon the privileges involved in the use of such property".

[1] It is settled, of course, that in granting a franchise to a corporation the state may limit the powers to be exer- [fol. 28] cised under it, annex conditions to its enjoyment, and require the corporation to contribute to the revenues of the state. (Home Ins. Co. v. New York, 134 U. S. 594.)

[2] A franchise tax is a tax imposed upon a corporation for the right or privilege of being a corporation or of doing business in a corporate capacity, and differs materially from property taxes as levied for state and municipal purposes in the basis prescribed for computing the amount of the tax. The doctrine of the taxability of corporate franchises, without reference to the character of the property in which their capital stock or their deposits are invested, has long since been established. (Society for Savings v. Coite, 73 U. S. 594; Prov. Inst. v. Mass., 73 U. S. 611.) Accordingly, it was early held that "where a tax is lawfully imposed upon the exercise of privileges within the taxing power of the state or nation, the measure of such tax may be the income from the property of the corporation, although a part of such income is derived from property in itself nontaxable". (Flint v. Stone Tracy Co., 220 U. S. 107, 163.) The cited case is principally relied on by the attorney-general as establishing the constitutionality of the act here under consideration. This doctrine, that the taxing power may with propriety include within a franchise tax base the interest received from tax exempt bonds, while never expressly overruled, seemed to have been greatly narrowed and restricted in its application by the decision in Macallen v. Massachusetts, 279 U. S. 260, decided by a divided court on May 27, 1929; but it must be noted that, in deciding in that case that the Massachusetts franchise tax act was unconstitutional, in so far as it purported to include in the tax base interest from tax-exempt securities, the Supreme Court did not see fit to overrule its decision in Flint v. Stone Tracy Co., supra, and the dissenting minority of the court, per Mr. Justice Stone, said: "There is no constitutional principle and no decision of this court, of which I am aware, which would deny to the state the power so to tax the privileges which it has conferred upon petitioner, even though all its property were tax-exempt securities of the United States and income derived from them. For seventy years this court has consistently adhered to the principle that either the federal or state governments

may constitutionally impose an excise tax on corporations for the privilege of doing business in corporate form, and measure the tax by the property or net income of the corporation, including the tax-exempt securities of the other or income derived from them. Provident Institution v. Massachusetts, [6 Wall. 611] supra; Society for Savings v. Coite, 6 Wall. 594; Hamilton Co. v. Massachusetts, [6 Wall. 632] supra; Home Insurance Co. v. New York, 134 U. S. 594; Flint v. Stone Tracy Co., 220 U. S. 107, 162-5. In Flint v. Stone Tracy Co., a federal tax on corporations 'with respect to carrying on or doing business' measured by net income, was held to be an excise, not a direct tax on property or income, and so was valid, although not apportioned under art. I, sec. 2, cl. 3, sec. 9, cl. 4 of the Constitution and notwithstanding the fact that net income from tax-exempt municipal bonds was included in the measure of the tax. In no technical sense does this tax seem open to objection. Being an excise the tax is not one on property or income and may include either in its measurement although not directly taxable."

If the Macallen case raised any doubt, the question seems to be now definitely settled. When this case now before us was submitted, there was pending in the United States [fol. 29] Supreme Court a case, Educational Films Corporation of America v. Ward, Atty. General of New York et al., which was an action to restrain the collection of a tax levied under the New York tax law which lays an annual tax on every domestic corporation of certain classes "for the privilege of exercising its franchise in [that] state in a corporate or organized capacity". The tax, payable in advance for each year, is at the rate of 4½ per cent of so much of the corporation's "entire net income" for the preceding fiscal year as is allocated to the business carried on within the state. Such "net income" embraces "income from any source", and "is presumably the same as the entire net income which such corporation is required to report to the United States, plus any income received as dividends on stocks or any interest received" from federal, state, municipal or other bonds. Subdivision 3 of section 208 of the Act provides: "The term 'entire net income' means the total net income, including all dividends received on stocks and all interest received from federal, state, municipal or other bonds * * *." The Films

Corporation was the owner of certain copyrights granted by the United States upon motion picture films, and had received royalties from the licensing of them. It challenged the tax assessed against it under the New York statute, supra, so far as it was measured by the amount of these royalties, because it was to that extent, it claimed, a tax on federal instrumentalities. The tax was upheld (51 Sup. Ct. Rep. 170). In the course of the opinion the court says: "The precise question now presented was definitely answered in Flint v. Stone Tracy Co., 220 U. S. 107, 162 et seq., which upheld a federal tax, levied upon a corporate franchise granted by a state, but measured by the entire corporate income, including, in that case, income from tax-exempt municipal bonds. In reaching this conclusion, the court reaffirmed the distinction, repeatedly made in earlier decisions, between a tax, invalid because laid directly on governmental instrumentalities or income derived from them, and an excise which is valid because imposed on corporate franchises, even though the corporate property or income which is the measure of the tax embraces tax-exempt securities or their income. See Society for Savings v. Coite, 6 Wall. 594; Provident Institution v. Massachusetts, 6 Wall. 611; Hamilton Co. v. Massachusetts, 6 Wall. 632; Home Insurance Co. v. New York, [134 U. S. 594] supra."

After citing and commenting upon many of its own decisions in which the same or similar questions had been considered, the court continues: "Having in mind the end sought, we cannot say that the rule applied by this court for some seventy years, that a non-discriminatory tax upon corporate franchises is valid, notwithstanding the inclusion of tax-exempt property or income in the measure of it, has failed of its purpose, or has worked so badly as to require a departure from it now; or that the present tax, viewed in the light of actualities, imposes any such real or direct burden on the federal government as to call for the application of a different rule.

"The decision of this court in Macallen Co. v. Massachusetts, supra, upon which appellant relies, was not such a departure. That case did not overrule Flint v. Stone Tracy Co., supra. Instead, the opinion rested the decision on the distinguishing fact that the tax-exempt securities were included in the measure of the franchise tax by virtue

of an amendment to the taxing statute which, it was held, was specifically intended to reach the income from tax- [fol. 30] exempt national and municipal bonds which had previously not been included in the measure of the tax."

[3] In adopting the constitutional amendment, supra, providing that all banks, including national banking associations, and all financial, mercantile, manufacturing, and business corporations shall annually pay to the state a tax to be measured by or according to their net income, and that the legislature may define net income "to be the entire net income received from all sources", the people of California were but following the recommendation of their tax commissioners, supra, and the governor (advance message to the legislature, August 16, 1928), that they accept the permission granted by the congress of the United States to tax national banks "according to or measured by net income". (Sec. 5219, U. S. Rev. Stats., supra.) The rate of taxation fixed by the legislature is not higher than the rate assessed upon state banks or other corporations. The tax is not a property tax. The state Constitution authorizes the scheme of taxation, and, under the decisions of the United States Supreme Court, the federal Constitution interposes no barrier to its operation. As said by the final authority on the question: "A tax very well may be upheld against any casual effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them." (Miller v. Milwaukee, 272 U. S. 713; Macallen Co. v. Massachusetts, supra, p. 831; Educational Films Co. v. Ward, supra.)

[4] Appellant's further contention, that the profits received by it from the purchase and sale of such nontaxable securities are also constitutionally exempt from taxation by the state, is without merit. In the very recent case of Willcutts v. Bunn (United States Daily, Tuesday, January 6, 1931, 51 Sup. Ct. Rep. 125) the United States Supreme Court determined that the federal government, under the provisions of the income tax act, might properly tax the profits realized on the sale of nontaxable state securities. The opinion declares, in substance, that in the case of tax-exempt securities, the subject held to be exempt from taxation is the principal and interest of the securities, but that

it does not follow that because a tax on the interest is a tax on the securities themselves and therefore forbidden, a non-discriminatory excise tax cannot be imposed upon the profits derived from the purchase or sale of such securities. The opinion states: "The sale of the bonds by their owners, after they have been issued • • • is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds." In view of this holding, we find no constitutional objection to the inclusion in the tax base of the profits received by appellant from the purchase and sale of the securities involved.

The judgment is affirmed.

Waste, C. J.

We concur: Richards, J.; Shenk, J.; Curtis, J.; Preston, J.; Seawell, J.

IN SUPREME COURT OF CALIFORNIA

DISSENTING OPINION

I dissent.

In my opinion, this cause falls squarely within the holding in the case of Macallen Co. v. Massachusetts, 279 U. S. [fol. 31] 620. The decision in the Macallen case recognizes the doctrine of the earlier case of Flint v. Stone Tracy Co., 220 U. S. 107, 163, to the effect that the taxing power may with propriety include within a franchise tax base the interest received from tax-exempt bonds, but declares that a tax upon the privilege of doing business measured in part by the amount of nontaxable interest received "may, nevertheless, be adjudged to lay a tax upon the interest, if that purpose be fairly inferable from a consideration of the history, the surrounding circumstances, or the statute itself considered in all its parts". Thus, a legislature may not by the artful use of words deprive the courts of their authority to look beyond the words to the real legislative purpose. It is for the courts to determine whether what is in form declared to be an excise tax is such a tax or, under the guise of such designation, is in substance and reality

a tax on the income derived from tax exempt property. In Miller v. Milwaukee, 272 U. S. 713, it is held: "If the avowed purpose or self-evident operation of a statute is to follow the bonds of the United States and to make up for its inability to reach them directly by indirectly achieving the same result, the statute must fail even if but for its purpose or special operation it would be perfectly good. * * * A tax very well may be upheld as against any casual effect it may have upon the bonds of the United States when passed with a different intent and not aimed at them, but it becomes a more serious attack upon their immunity when they are its obvious aim."

After a careful examination of the Massachusetts tax commission's report, which report undoubtedly led to the adoption of the act there attacked, and following a critical study of the act itself, the United States Supreme Court in the Macallen case, supra, declared the Massachusetts franchise tax act to be in violation of the congressional mandate exempting federal bonds and securities from taxation, and in violation of the contract clause of the Constitution, in so far as it purported to include in the tax base, interest from tax-exempt securities. While the tax in that case was designated as a "franchise tax", the court concluded from the history and circumstances surrounding its enactment that it was plainly the intention of the Massachusetts legislature to include the interest from tax-exempt securities within the tax base in order that such nontaxable securities, held in large quantities by banks and other financial corporations, might, indirectly at least, be made to bear their proportionate share of the tax burden. In other words, it was held that the act in substance and effect imposed a tax upon the exempt securities themselves in violation of the constitutional inhibition—the burden falling upon them by their use as a measure not being casual and incidental.

If, therefore, it be reasonably ascertainable that interest from tax-exempt property is included within the tax base of a franchise tax measured by net income for the purpose of reaching such nontaxable property or the income therefrom, the tax, at least in this particular, is unconstitutional and void. In so deciding the Macallen case the court did not find it necessary to overrule Flint v. Stone Tracy Company, supra, though the actual objective operation of the

tax upheld in the Flint case and that condemned in the Macallen case is identical. There can be no question, therefore, but that the court in the Macallen case held the tax void solely for the reason that it was enacted with the purpose of reaching nontaxable property.

Application of that test satisfies me that the California [fol. 32] Bank and Franchise Tax Act, supra, must fall with the Massachusetts statute in so far as it attempts to include interest from tax-exempt property in the tax base. For all practical purposes the two acts are substantially the same. Each designates the tax therein imposed as a "franchise tax", as distinguished from a property tax, but, as we have already seen, there is no magic in those words. It is our duty to look beyond the mere form of the statute and determine what, in truth and in substance, is its purpose and effect. True, as pointed out by the attorney-general, the Massachusetts attempt to include interest from tax-exempt securities within the tax base was the result of a deliberate amendment of its taxing statute to this effect whereas our statute, as originally enacted, included such interest in the tax base. To conclude that this fact alone warrants a distinction between the two cases is to hold that Massachusetts cannot take in two bites what California can have in one. Our investigation discloses that substantially the same reasons prompted the enactment of the California statute that resulted in the adoption of the Massachusetts law. The special and final reports of the California tax commission, which undoubtedly were before the legislature when it enacted the tax law corresponding to the Massachusetts tax statute, contained in substance the same observations on the possibility of reaching exempt securities as did that before the Massachusetts legislature which is quoted by the Supreme Court in the Macallen case as showing an intention to tax them by indirection. Both reports of the local taxing commission state: "As has been pointed out, the 1926 amendment to section 5219 [authorizing the taxing of national banks 'according to or measured by net income'] was drafted with the avowed object of permitting the inclusion in the tax base of such income as the interest from tax-exempt bonds. In the case of corporations other than banks, the point is not of vital importance. But the banks hold such large quantities of these tax-exempt bonds that the effect of a decision holding that the state may not

include them in the base would be very serious indeed. An analysis of the replies of the banks to the commissioner's questionnaire indicates that the noninclusion of federal bond interest would reduce that base by more than one half." With this information before it, the commission suggested to the governor and to the legislature the inclusion of tax-exempt interest in the tax base, arguing that otherwise "no substantial tax would be forthcoming from the banks". The commission appreciated the fact that the validity of the plan it was recommending had not, at that time, been judicially determined, for in its report it recognized that "a suit [the Macallen case] has already been filed in Massachusetts questioning the right of a state to include such interest". The commission's report also makes reference to the fact that New York and Massachusetts had already enacted tax statutes similar to the one proposed, thus evidencing an intention to pattern the California act after the Massachusetts statute, which has now been declared unconstitutional in the Macallen case. Then again, at the public hearing on the proposed tax measure held on January 17, 1929, before the senate and assembly sitting in committee of the whole, Professor R. M. Haig of Columbia university, who had served as technical advisor to the tax commission, while referring to the proposed tax as a "ffanchise tax" imposed for the privilege of doing business as a corporation, informed the legislature that "Interest from tax-exempt bonds is an exceedingly important item in a tax which is applied to banks." (State [fol. 33] Printing Office Publication No. 64915.) As further indicating the intent with which the California statute was proposed, and pointing out some of the difficulties confronted by the proposed act. Professor Haig, writing in the bulletin of the National Tax Association, volume XIV, page 231, 236, under date of May, 1929, states: "The proposal of the board of supervisors of San Francisco [to exclude from the tax base the interest on nontaxable securities] carried a threat of complete disaster. The exclusion of tax-exempt interest from the base was of importance only in the case of banks, who were the only large holders of government bonds. For them it meant practically complete exemption. Several of the largest and most prosperous banks in the state * * * would pay no franchise tax whatsoever. The banks themselves did not want this ex-

emption and it was they who produced evidence which on the very day of the vote on the bill convinced the San Francisco officials that its passage would not unfavorably affect the flotation of the municipal issues. Had their proposal [to exclude tax-exempt interest] prevailed the new tax would have been completely wrecked."

I am of the view that both the form and effect of the Massachusetts and California statutes are substantially identical so far as concerns the qualities that led the Supreme Court of the United States to hold the former tax void. I am also satisfied that in enacting the California Bank and Corporation Franchise Tax Act, supra, it was the legislative intention and purpose to reach nontaxable securities by including in the tax base interest received thereon. Under the holdings in Miller v. Milwaukee, supra, and the Macallen case, supra, this feature strikes at the validity of the act. It is no sufficient answer to state that the act was an emergency measure, enacted to avert a crisis which threatened the revenues of the state, or that it was intended to give to the state a modernized system of bank and corporate taxation, for in declaring the Massachusetts statute invalid as an attempt to reach nontaxable securities, the federal Supreme Court did not find that the legislature might not have other and legitimate motives as well. There can be no doubt but that the California tax commission suggested and the legislature adopted an act including interest from tax-exempt securities in the tax base, because both were convinced that banks and other corporations held such large quantities of these nontaxable securities as to require such a tax base in order to receive a "substantial tax" from such entities. The tax was aimed directly at the nontaxable securities and the interest received therefrom. In line with the decision of the Supreme Court of the United States in the Macallen case I must, therefore, conclude that in so far as the Bank and Corporation Franchise Tax Act, of this state, attempts to include interest from federal, state, municipal or other tax-exempt bonds in the tax base upon which the taxes of state banks and corporations are computed, the act in substance and effect imposes a tax upon such tax-exempt securities and is invalid and void. As to the federal bonds and securities, the act is in derogation of the constitutional power of congress to borrow money on the credit of the United States, as well

as in violation of the acts of congress declaring such bonds and securities to be nontaxable. Applying the test set up by the federal court, the same considerations that govern in the case of federal securities determine the impropriety of including the income from state, county, city and county, municipal or district bonds under the tax base measure-[fol. 34] ment plan adopted in the act. If such income is included, the act impairs the obligation of the contract created by section 1¾ of article XIII of the state Constitution, which provides that such bonds and securities "shall be free and exempt from taxation". That surely must be so as to bonds and securities issued before November 6, 1928, the date on which section 16 of article XIII of the Constitution was adopted.

The decision in the case of Educational Films Co. v. Ward, 51 Sup. Ct. Rep. 170, cited in the majority opinion, does not overrule the Macallen case but, on the contrary, is distinguishable therefrom and follows closely the earlier decisions of the United States Supreme Court. It recognizes, as does the Macallen case, that the courts must look beyond the mere form and language of a taxing statute and determine its operative effect; that is to say, the legislative characterization of a taxing statute as a "franchise" tax act is not binding on the courts if it appears that the act in substance and effect imposes an ad valorem or property tax. It also recognizes that the doctrine announced in Flint v. Stone Tracy Co. is not overruled by the holding in the Macallen case and that under the former, a state may well include within the measure of a "franchise" tax, the interest or income from tax-exempt property, but that, under the holding in the latter case [the Macallen case] this is so only when such inclusion is merely "casual and incidental" and not the result of an attempt to tax indirectly what cannot be reached directly. In other words, the decision in the Educational Films Co. case, so strongly relied on in the majority opinion, merely recognizes the two lines of cases represented by Flint v. Stone Tracy Co. and Macallen v. Massachusetts and then concludes that the New York statute involved in the Educational Films Co. case includes the income from copyrights only as an incident to the imposition of a proper franchise tax upon net income and therefore falls within the category of statutes upheld in the Flint case. In distinguishing the New York

act from the Massachusetts act declared unconstitutional in the Macallen case, the court in the Educational Films Co. case declares: "But the statute, before these amendments was sufficiently broad to include income from copyrights within the measure of the tax; and neither before nor after the amendments did it make any mention of copyrights or their income. There is nothing to suggest that the legislature could at any time have had in mind the addition of income from copyrights to the measure of the tax, or that the statute or the amendments were adopted 'for the very purpose of subjecting' it 'pro tanto to the burden of the tax', which was declared to be the vice of the statute in Macallen Co. v. Massachusetts, supra, p. 631. That the royalties play some part in the measure of the tax is the result of the application of the general language of the statute to particular circumstances to which the statute makes no specific reference. In this respect, the present statute differs in no substantial way from that upheld in Flint v. Stone Tracy Co., supra." (The statute in Flint v. Stone Tracy Co., supra, made no specific reference to tax-exempt property, such property being only incidentally included in the tax base by reason of the general language of the act referring to income from "all sources".)

From the foregoing quotation, taken from the Educational Films Co. case, it is quite clear that the New York statute there upheld made no specific reference to the in- [fol. 35] come from nontaxable copyrights but such income was included within the tax base solely by reason of the general language of the act requiring the inclusion of "income from any source". (Section 209 of the New York act.) In other words, the inclusion of income from nontaxable copyrights in the New York tax base was only "casual and incidental" to the imposition of the tax and not the result of any discoverable intent or purpose to include such income in order to reach the nontaxable subject itself.

Our statute, on the other hand, as already pointed out, makes specific reference to and requires the inclusion of tax-exempt interest from nontaxable bonds in the tax base, thus evidencing an intent and purpose, discoverable upon the face of the statute, to include such interest in the tax base as a means of requiring holders of tax-exempt securities to bear their proportionate share of the tax burden.

Then, as further pointed out, this express purpose and intent of the legislature is clearly evidenced by the report to the legislature of the California Tax Commission, which report, under the holding in the Macallen case, may properly be referred to as showing the legislative intent, and also by the quotation of statements made before the senate and assembly when sitting as a committee of the whole, and considering the enactment of the California Bank and Corporation Franchise Tax Act.

That provision of the New York statute, quoted in the majority opinion herein, which calls for the inclusion of interest from municipal and other nontaxable bonds within the tax base, though substantially the same as our act in this particular, was not before and was not considered by the United States Supreme Court in the Educational Films Co. case. That case and the decision therein were concerned solely with the inclusion in the tax base of the income from copyrights, which income was only casually and incidentally included therein by reason of the general language of the act requiring the inclusion of income from "any source". However, as already indicated, it is apparent, both upon the face of the California statute and from the legislative history thereof, that the inclusion of the interest from tax-exempt bonds was not "casual and incidental" but deliberate, the intent being to tax indirectly what could not be reached directly.

In conclusion, therefore, it may be said that the holding in the Educational Films Co. case is entirely consistent with the earlier decisions of the United States Supreme Court, but the statute there involved, so far as it concerned itself with the income from tax-exempt copyrights, the only question then before the court, properly fell within the doctrine set down in Flint v. Stone Tracy Co., whereas the California act, so far as the interest from nontaxable securities is involved, falls clearly within the category of statutes condemned in the Macallen case and is therefore unconstitutional in this respect.

Langdon, J.

[fol. 36] IN SUPREME COURT OF CALIFORNIA

Bank

Sacramento No. 4500

THE PACIFIC CO., LTD., a Corp., Plaintiff, Appellant,

vs.

CHARLES G. JOHNSON, State Treasurer of the State of California, Defendant, Respondent

On Appeal from the Superior Court in and for the County of Sacramento

JUDGMENT—Mar. 31, 1931

The above entitled cause having been heretofore fully argued, and submitted and taken under advisement, and all and singular the law and premises having been fully considered,

It is ordered, adjudged, and decreed by the Court that the Judgment of the Superior Court in and for the County of Sacramento in the above entitled cause be, and the same is hereby, affirmed, Respondent to recover costs of appeal.

Clerk's certificate to foregoing paper omitted in printing.

[fol. 37] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 38] IN SUPREME COURT OF THE UNITED STATES

STATEMENT OF POINTS TO BE RELIED UPON AND DESIGNATION TO PRINT ENTIRE RECORD—Filed July 31, 1931

Comes now the appellant and adopts its assignments of error as its statement of the points to be relied upon, and represents that the whole of the record, as filed, is necessary for the consideration of the case.

Joseph D. Peeler, Counsel for Appellant.

Dated June 24, 1931.

[fols. 39 & 40] UNITED STATES OF AMERICA,
State of California,
County of ——:

Due and sufficient service of the within statement of points to be relied upon and designation of the parts of the record to be printed in the above entitled case is hereby accepted.

Charles G. Johnson, State Treasurer of the State of California, by H. H. Linney, Deputy Attorney General.

[fol. 41] [File endorsement omitted.]

Endorsed on cover: File No. 36,084. California Supreme Court. Term No. 270. The Pacific Co., Ltd., appellant, vs. Charles G. Johnson, State Treasurer of the State of California. Filed July 31, 1931. File No. 36,084.